

Message Text

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SUBJ: MONETARY DEVELOPMENTS

SUMMARY: THE OFFICIAL DISCOUNT RATE WAS REDUCED FROM 11 PERCENT TO 10 PERCENT ON DECEMBER 7 AND LIMITATIONS ON BANK CREDIT SUBSEQUENTLY RAISED BY TWO PERCENT. THIS MONETARY EASING WAS MADE POSSIBLE BY THE RECOVERY OF FOREIGN EXCHANGE RESERVES AFTER THE CENTRAL BANK HAD REPAID THE SUBSTANTIAL INTERVENTION DEBTS INCURRED LAST AUGUST TO OCTOBER. THE FLOWBACK OF RESERVES ALSO KEEPS THE DANISH KRONE STABLE AT THE TOP OF THE SNAKE. HOWEVER, AS TRADE AND PAYMENTS DEFICITS ARE STILL LARGE, RESERVES HAVE BEEN BOLSTERED MAINLY BY EXTENSIVE LONG-TERM GOVERNMENT BORROWING ABROAD, WHICH IS LIKELY TO CONTINUE IN 1977. END SUMMARY

1. THE DANMARKS NATIONALBANK (CENTRAL BANK) ON DECEMBER 7 REDUCED THE OFFICIAL DISCOUNT RATE AND PRIMARY LENDING RATE (RATE TOWARD BANKS) FROM 11 PERCENT TO 10 PERCENT. THESE RATES WERE INCREASED FROM 8.5 PERCENT TO 11 PERCENT LAST OCTOBER WHEN INTERNATIONAL MONETARY UNREST HAD EXERTED HEAVY PRESSURES ON THE DANISH KRONE AND FOREIGN EXCHANGE RESERVES. THE REALIGNMENT OF THE SNAKE CUR-
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RENCIES ON OCTOBER 18 OFFERED IMMEDIATE RELIEF, HOWEVER,

AND A NORMALIZATION OF THE DISCOUNT AND INTEREST RATES HAS BEEN EXPECTED FOR SOME TIME. THE OPEN BOND MARKET REGISTERED AN ABOUT ONE TO TWO PERCENT INTEREST RATE DECLINE OVER THE PAST MONTHS. FURTHER DISCOUNT RATE REDUCTIONS ARE ANTICIPATED DURING THE WINTER.

2. THE CENTRAL BANK SUBSEQUENTLY RAISED THE STATUTORY LIMITATION ON BANK CREDIT BY A MODEST TWO PERCENT. THE CREDIT CEILING WAS RAISED TWICE BEFORE THIS YEAR, BY THREE PERCENT LAST FEBRUARY AND BY TWO PERCENT LAST AUGUST. BECAUSE OF LOW CREDIT UTILIZATION, THE CREDIT LIMITATION DID NOT PROVE VERY RESTRICTIVE DURING THE TROUGH OF RECESSION, BUT THE PICTURE HAS CHANGED IN 1976. CONSUMER CREDIT, PARTICULARLY, SHOWED AN INCREASE. AS THE CREDIT CEILING WAS RAISED, CREDITS GRANTED ROSE BY 5-6 PERCENT DURING THE YEAR BUT DRAWINGS AGAINST CREDIT ROSE 15-16 PERCENT.

3. BY THE END OF NOVEMBER, FOREIGN EXCHANGE RESERVES WERE RESTORED TO A LEVEL WELL OVER ONE BILLION DOLLARS, THE LEVEL WHICH PERSISTED THROUGH MOST OF 1975 BUT STILL SOME 25 PERCENT BELOW THE PRE-OIL-CRISIS LEVEL OF 1973. RESERVES BOTTOMED AT THE END OF SEPTEMBER AND EARLY OCTOBER WHEN THE HEAVY CURRENT ACCOUNT

DEFICIT WAS AGGRAVATED BY LARGE CAPITAL OUTFLOWS IN THE PRIVATE SECTOR. THE CENTRAL BANK WAS FORCED TO INTERVENE IN SUPPORT OF THE DANISH KRONE TO THE EXTENT OF ONE BILLION DOLLARS DURING THE PERIOD PRIOR TO THE REALIGNMENT OF THE SNAKE CURRENCIES.

4. THE OUTFLOW OF RESERVES ALSO AFFECTED LIQUIDITY IN THE BANKING SYSTEM WHICH AT ONE TIME EXHAUSTED ITS DISCOUNT FACILITIES COMPLETELY. RATHER THAN OPENING THE DISCOUNT WINDOW FURTHER, THE CENTRAL BANK WENT INTO THE DAY-TO-DAY MARKET BUT KEPT RATES HIGH IN ORDER TO DISCOURAGE DEMAND FOR FORWARD FOREIGN CURRENCY. THE MARKET BECAME SOMEWHAT EASIER IN NOVEMBER.

5. THE REALIGNMENT OF THE SNAKE CURRENCIES ON OCTOBER
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18 THEORETICALLY PROVIDED FOR A DEVALUATION OF THE DANISH KRONE BY 6 PERCENT AGAINST DEUTCHMARK AND BY HALF THAT RATE AGAINST THE SCANDINAVIAN CURRENCIES. ACTUAL DEVELOPMENTS, HOWEVER, HAVE KEPT THE KRONE AT THE TOP OF THE SNAKE EVER SINCE. IF ONE INCLUDES THE RELATIONSHIP OF THE KRONE TO STERLING AND OTHER FLOATING CURRENCIES, THE ACTUAL KRONE DEVALUATION HAS AMOUNTED TO ONLY ONE PERCENT. THIS IS A VERY SMALL

ADJUSTMENT COMPARED TO THE ACTUAL REVALUATION OF THE KRONE WHICH TOOK PLACE BETWEEN MID-1976 AND OCTOBER AT THE RATE OF 4-5 PERCENT. IT IS GENERALLY EXPECTED THAT THE PRESENT FLOWBACK OF RESERVES WILL BE COMPLETED BY EARLY 1977. IN THAT CASE THE KRONE WILL REVERT TO A MORE NORMAL POSITION IN THE SNAKE, AND THE KRONE DEVALUATION HAVE A GREATER EFFECT.

6. VERY LARGE IMPORTS IN 1976 AND ONLY MODERATE EXPORT GAINS WILL BRING THE 1976 DEFICIT ON CURRENT ACCOUNT TO A RECORD LEVEL OF ABOUT 1,800 MILLION DOLLARS. THE GENERAL EXPECTATION IS THAT THE DEFICIT WILL BE REDUCED BY ONE-FOURTH TO ONE-HALF IN 1977. AS THE PRIVATE SECTOR DURING THE FIRST THREE QUARTERS OF 1976 PAID OFF DEBTS IN EXCESS OF ONE-HALF BILLION DOLLARS, RESERVES WERE MAINTAINED ONLY BY EXTENSIVE GOVERNMENT BORROWING ABROAD. LONG-TERM FOREIGN LOANS WERE SIGNED DURING 1976 FOR ABOUT TWO BILLION DOLLARS, MOST OF WHICH WERE UTILIZED DURING THE YEAR. DESPITE AN APPARENT REVERSAL OF PRIVATE CAPITAL FLOWS SINCE OCTOBER, THE CONTINUED AND ANTICIPATED PAYMENTS DEFICITS WILL ALSO NECESSITATE PUBLIC BORROWING ABROAD IN 1977, THOUGH PROBABLY NOT QUITE AT THIS YEAR'S RATE.
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